

LOW-INCOME HOUSING TAX CREDIT PROGRAM

Prior to 1986, substantial financial incentives existed for owners of low-income housing projects. These incentives included the deduction of construction period interest and taxes, accelerated depreciation and amortization of building costs. However, Congress eventually determined that investment benefits to owners and investors in real estate were overly generous. The outcome of this process was the Tax Reform Act of 1986, which resulted in the loss of many of these incentives.

At the same time that Congress was eliminating general real estate investment incentives, they were also trying to create sufficient incentives for investment in low-income housing. The end result was the creation of the Low Income Housing Tax Credit (LIHTC) program, which is included as Section 42 of the Internal Revenue Code. The Low Income Housing Tax Credit is an incentive program created to encourage the construction or rehabilitation of buildings for low-income tenants.

These tax benefits can also be used by developers to attract investors who commit their dollars to a project in return for a share of the tax credits and other benefits. The tax credit program differs from previous incentives in that the program does not provide deductions to the investor's income but provides, instead, credits which can be used against the investor's tax liability. Another departure is that the program is administered by the U.S. Department of the Treasury and is not a part of the Department of Housing and Urban Development (HUD) as are most other federal housing programs.

Section 42 stipulates that the credit will be allocated on the state level and requires each state to designate an agency to administer the program. This agency is called the "allocating agency". The Utah Housing Corporation (the "Corporation" or "UHC") is the designated allocating agency for the state of Utah. States can only allocate credits within their state boundaries, and UHC is the only agency in Utah authorized to issue these credits. The laws governing the program impose many requirements on owners, which the UHC must administer and monitor. The allocating agency also has

the ability to develop additional requirements beyond the federal code for administering the program. State guidelines may be more restrictive than federal guidelines.

Generally, each state may allocate a specified amount of credit (annual authority) per year to qualified projects in the state. The amount of annual authority is based primarily on the per capita population of the state. A state may allocate an amount equal to \$2.10 per resident per year. For instance, if the state population for a given year was 2,800,000, the credit available for that year would be \$5,880,000 (2,800,000 X \$2.10). The dollar amount of credit for Utah is approximately \$5,880,000.

In addition to the per capita credit authority amount, the state may gain additional authority from other sources. These sources include credits forfeited by projects which were not completed and excess credits from completed projects. The state may also receive additional credits from a National Pool composed of the unused credit of other states. Additional credits are given directly from the federal treasury with no limit to the state to projects that obtain Section 103 tax exempt bond authority. These projects must apply for the treasury credits through UHC.

The Housing Tax Credit program is the longest running multi-family housing program ever implemented at the federal level. It has proved to be a very effective program for housing low and very low-income families throughout the country.

Questions and Answers about LIHTC

Q: What is a tax credit and who is eligible?

A: The Low Income Housing Tax Credit is a dollar-for-dollar credit or reduction of tax liability for owners and investors in low-income housing. The credit is available annually for ten years. The amount of credit awarded to a project is based on the costs of developing an approved low-income project and the number of qualified low-income units in the project. The credit is not a deduction or adjustment to income, which is subtracted before the tax is calculated; instead, it is subtracted after the total tax amount is determined. A tax credit, therefore, is significantly more valuable than a deduction.

Q: Are there limits on the investor in the use of the credits?

A: Individual investors in a tax credit project are subject to the passive loss, passive credit, and at-risk rules in the federal tax law. For instance, under the passive loss and credit rules, certain individual investors may use the LIHTC up to an amount equal to the deduction equivalent of \$25,000 per year at the individual's marginal tax rate (e.g., \$9,900 per year at a 39.6% marginal tax rate [$\$25,000 \times 39.6\% = \$9,900$]). Hence, an investor may only use up to \$9,900 of the project's maximum annual credit against their federal income tax each year without actually participating in the project. Certain for-profit corporations not subject to the passive credit and at-risk rules may be able to use an unrestricted amount of credit each year.

The credit is also part of the general business credit and therefore subject to the limits on such credit.

Q: What if I can't use all of the credits myself; can I sell the credits?

A: Credits can only be used by the "owner" of a project. Therefore, the sale of credits alone is not allowable. As a result of the limits imposed on the individual investor and the inability of the owner to sell credits alone, a project is usually syndicated. Ownership of the project is generally structured as a limited partnership between the developer/owner and the investor who then share the "benefits and burdens" of ownership. These partnership transactions involve a number of complex tax issues and securities law considerations, which should be discussed with experienced counsel before attempting.

Q: What types of buildings and rental units are eligible for the credit?

A: The credit is available for residential rental buildings, which are part of a qualified low-income housing project. The rental housing units must be available for the general public.

Owners may give preference to individuals with special needs such as the elderly, handicapped, or homeless, consistent with the Fair Housing Act.

Single room occupancy (SRO) housing rented on a monthly or longer basis, certain transitional housing for the homeless, and mixed-use projects with commercial space are eligible for tax credits. However, any commercial portion of the project is not eligible for credit. Projects receiving moderate rehabilitation assistance under the Stewart B. McKinney Homeless Act of 1988 are also eligible for credits.

Q: What types of buildings and rental units are not eligible for credit?

A: Generally, buildings that do not qualify as residential properties include: (i) transient housing, hotels (leased for less than 6 months), (ii) buildings which have four or less units where the owner or relative of the owner lives in the project, (iii) nursing homes, (iv) lifecare facilities, (v) retirement homes providing significant services other than housing, (vi) dormitories, (vii) trailer parks, (viii) and most student housing are not eligible for credit. In addition, buildings, which receive moderate rehabilitation assistance under the HUD Section 8(e)(2) moderate rehabilitation program, do not qualify for credit.

Q: How much credit can a project get?

A: The code specifically states that the maximum credit given to a project cannot exceed the amount necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. UHC must consider the sources and uses of funds and the total financing for the project as well as any proceeds from the sale of the credits.

The law provides for two credit rates (applicable percentages) depending on the type of project you are proposing. When the program was created, these rates were set at 9% and 4%. After 1987, however, the applicable percentages were adjusted on a monthly basis by the U.S. Department of the Treasury. The rates are adjusted so that, depending on the type of project proposed, the present value over a ten-year credit period would equal 70% or 30%, respectively, of the building's qualified basis (cost).

The two credit types are described as follows:

The 70% present value credit (the “9% credit”) is available for new construction and substantial rehabilitation projects without federal subsidies. To qualify as substantial rehabilitation, the rehabilitation expenditures incurred during any 24-month period must equal the greater of \$6,000 per low-income unit.

The 30% present value credit (the “4% credit”) is available for projects that involve acquisition of an existing building, or for projects that are federally subsidized. A federal subsidy includes construction or rehabilitation costs that are financed, directly or indirectly, with tax-exempt bonds or a federal loan that have interest charges below the rate for comparable market loans. To receive the acquisition credit, the project must include substantial rehabilitation (replacement of two or more building systems). The owner may subtract the federal subsidy amount from the project’s basis to use the 9% calculation on the remaining balance.

UHC must determine that the project receives no more credits than required to make it feasible. This review occurs several times during the allocation process: at time of application, Carryover Allocation and again at the time the project is completed and final costs and financial resources are accounted for. The actual tax credit rates are elected by the owner as follows: when the owner enters into a Carryover Allocation Agreement with the state or the rate available when the building is placed in service. The purpose for a fluctuating tax credit rate is to allow a larger allocation during periods of high interest rates, which would complement the lower mortgage available during high interest rate periods. The opposite would be true during low interest periods, which would allow for a larger mortgage, thus requiring a lower tax credit allocation. Once specified by the owners, the rate remains the same for the credit period.

If your project is financed by tax-exempt bonds, the rate is limited to the 30% present value rate (the “4% credit”), and the rate is determined by the date in which the bonds are issued or if you elect to lock in the rate before the last day of the month the month that the bonds are issued.

Q: How do I obtain credits for my project?

A: In 1990, Congress mandated a competitive process to obtain tax credits. Each state is required to develop and implement a Qualified Allocation Plan that sets forth the requirements to compete and obtain tax credits. UHC’s plan sets forth the administrative, as well as scoring and monitoring requirements. The Qualified Allocation Plan is available by email or can be downloaded from http://b2b.utahhousingcorp.org/PDF/2010_QAP.pdf

Q: Do I have to complete a project the same year I get credits?

A: It is not necessary to complete the building in the same year. However, if completed in the same year it received credit, a cost certification must be received by UHC on or before December 1 of that year. Projects not completed in the same year can extend the credit reservation two calendar years by entering into a Carryover Allocation Agreement at any time after the reservation agreement has been entered in to, but before November 1 of that year. A project must expend 10% of the aggregate basis of the project within one year from the date of the Carryover Allocation Agreement.

Q: Are there other credit available to assist in the building of affordable housing?

A: In 1994, the Legislature of the State of Utah passed a bill authorizing the allocation of state of Utah tax credits that offset individual and corporation income taxes. The Utah Housing Corporation is the designated administrator of the State of Utah Low Income Housing Tax Credit (“Utah Credit”) Program (the “State Tax Credit Program”) for the State of Utah under Sections 57-7-607 and 59-10-1010 of the Utah Code Annotated 1953 (the “Utah Code”). The objective of the State Tax Credit Program is to encourage the construction, rehabilitation and preservation of rental housing for very low, low and moderate-income households earning no more than 60 percent of the area median income in the State of Utah and can only be used on projects that have Federal Tax Credits.

In order to most efficiently administer the State Tax Credit Program and to most effectively allocate this very limited resource to certain selected projects; UHC has incorporated the Utah Housing Credits into the Federal Qualified Allocation Plan. Generally, Utah Housing Credits are requested as part of the federal application to reduce rents beyond those proposed in the federal application to reduce rents beyond those proposed in the federal application. The State Tax Credit Program is ONLY available to projects that have received a reservation or allocation of Federal Tax Credits under Section 42 of the Internal Revenue Code.

The Utah Credit mirrors the federal credit. It is a ten-year credit that can be, when needed, disproportionately allocated to a third investment member when the federal credit investor does not have a Utah tax liability.